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No. 447.

In the Supreme Court of the United States.

OCTOBER TERM, 1923.

THE UNITED STATES, APPELLANT,

v.

THE SHEFFIELD-BIDDLE HARDWARE COMPANY.

APPEAL FROM THE COURT OF CLAIMS.

BRIEF FOR THE APPELLANT.

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BRIEF FOR THE APPELLANT.

The point involved in this case is whether the proceeds of a policy of life insurance, taken by a corporation upon the life of its president and paid to the corporation upon his death, is taxable income under the Revenue Act of 1918. The Court of Claims held that it was not, and the United States appeals.

THE FACTS.

The Supplee-Biddle Hardware Company was a Pennsylvania corporation engaged in the business of selling hardware and similar merchandise. It was organized about January 1, 1914, by a consolidation of the Biddle Hardware Company and the Supplee Hardware Company. At the time of the consolidation Robert Biddle, who had been associated with the Biddle Hardware Company since

the year 1899, became the general manager of the new company. On February 14, 1917, he was elected president and continued to hold that office until his death. He was at that time 37 years old, in perfect physical health, and a good moral risk. At that time the outstanding capital stock of the company was of the par value of $800,000, and its annual sales were about $450,000.

In April, 1917, at the instance of the directors of the company Mr. Biddle took out two policies of insurance upon his life, payable in the event of his death to the company as beneficiary. These policies were for $50,000 each and were for a term of five years. The premiums were paid by the company, and by the terms of the policies the company was not to recover any of the premiums or any other principal sum except by reason of the death of Mr. Biddle.

"The policies were taken out for the purpose of providing a fund to make secure the financial position of the company in the event of the death of" Mr. Biddle and to indemnify the company "against losses to its earning power which his death would occasion" (p. 5).

Mr. Biddle was a man of ability, energy, and initiative, and was so regarded in the hardware trade and by the banks with which the company dealt. At the time of his death there was no member of the company qualified to take his place, and it was more than a year before a person could be found who was suitable to act as president of the company.

On October 12, 1918, Mr. Biddle died of influenza. The proceeds of the policies were paid to the company and the net proceeds, after deducting the amount of the premiums paid, amounted to the sum of $97,947.28.

In filing its return for the year 1918 the company did not report as part of its income the proceeds of said policies, though it did attach to its return a memorandum setting forth the facts. Upon reexamination of the return an additional tax based upon the receipt of the proceeds of these policies was assessed, and after some further adjustments was paid. Appropriate relief was sought by claim for refund, and upon denial thereof suit was brought in the Court of Claims. That court rendered judgment against the United States for the sum of $55,153.89, with interest, and from that judgment the United States appeals.

THE STATUTE.

The statute involved is the Revenue Act of 1918 (Act of February 24, 1919), ch. 18, 40 Stat. 1057. Section 213 of the act, so far as it is material, provides as follows (p. 1065):

> That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the

United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(2) The amount received by the insured as a return of the premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); * * *.

ARGUMENT.

I.

Under the terms of the Revenue Act of 1918 the proceeds of life insurance payable to corporate beneficiaries are taxable as income.

Part II of the Revenue Act of 1918, including section 213 already quoted, is headed "Individuals." Part III is headed "Corporations," and section 232 of the act, included in that title, provides that—

> "net income" means the gross income as defined in section 233 less the deductions allowed by section 234,

and section 233 (a) provides that:

> in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213,

with certain exceptions not material. Therefore, the definition of gross income in the case of a corporation is exactly the same as in the case of an individual. It would be difficult to employ language more universally inclusive than that used in section 213. It includes gains, profits, and income derived from any source whatever, and the specific mention of certain forms of income can not narrow the meaning of this all-inclusive language. It is the claim of the Government that the proceeds of these insurance

policies represented a gain, a profit, and an income growing out of the transaction of a business carried on for gain or profit. If the general language admits of any doubt, the specific language removes the doubt. That Congress, in all legislation passed since the Sixteenth Amendment, regarded the proceeds of life insurance policies as a form of income which they had authority to tax is shown by a comparison of the language used in the various acts. The first statute was the Act of October 3, 1913, ch. 16, 38 Stat. 114. Section II of that act, subdivision B, after defining in the most general terms the definition of income, contains this proviso:

> That the proceeds of life insurance policies paid upon the death of the person insured * * * shall not be included as income.

This was in the part of the Act relating only to individuals, and the Commissioner ruled that it did not include Corporations. T. D. 2090. Dec. 14, 1914.

The next act was the Act of September 8, 1916, ch. 463, 39 Stat. 756. Section 4 of that act provides:

> The following income shall be exempt from the provisions of this title: The proceeds of life insurance policies paid to *individual beneficiaries* upon the death of the insured * * *.

The Act of October 3, 1917, 40 Stat., ch. 63, p. 300, reenacted the provisions of the Act of 1916.

The proviso in the Act of 1918 is (section 213):

> The proceeds of life insurance policies paid upon the death of the insured to *individual beneficiaries or to the estate of the insured.*

In the Act of November 23, 1921, 42 Stat. 227, ch. 136, the proviso reads:

> The proceeds of life insurance policies paid upon the death of the insured.

It appears, therefore, that the question of the taxation of the proceeds of life insurance policies as income has been considered by Congress five times since the Sixteenth Amendment, and in each case they have been regarded as potential sources of income tax. In 1913 they were exempt when paid to individuals. In 1916 Congress inserted the words "paid to individual beneficiaries" and so expressly limited the exemption to such policies. This was continued in the Act of 1917. In the Act of 1918, however, another exemption appears, for, in addition to the proceeds of policies paid to individual beneficiaries, the exemption was made applicable to policies paid to the estate of the insured. In 1921 Congress returned to the provision in the original Act of 1913, which by the operation of section 233 made the proceeds of all life insurance policies exempt. In the face of this history of legislation and of these changes obviously made with deliberate intent, can there be any serious claim that the respective changes should not be given the full effect which their language imports? The intent is clear. First, the proceeds of life insurance policies were exempt when paid to individual beneficiaries, and this restricted exemption was continued until after the armistice. Then the exemption was further extended to include policies payable to the estate of

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the insured, and finally, after the war was over and the necessity for extreme taxation had passed, the restrictions were wholly removed, and they are now wholly exempt.

The Court of Claims in construing the provisions of the Act of 1918 said (p. 8):

> It will be observed that no mention was made of the proceeds of life insurance in that part of the act dealing with corporations. The fact that in that part of the act dealing with individuals mention was made specifically of proceeds of life insurance can hardly be used to carry the implication that such proceeds must be regarded as income when they are received by corporations.

This language of the Court of Claims seems to disregard entirely the language of section 233, already quoted, which says that the term "gross income" means the gross income as defined in section 213. Language could not be plainer. The gross income of a corporation is, in so many words, defined in the same language as the gross income of an individual. The court continues:

> It would be more logical to imply that as the act declared the proceeds of policies of life insurance was not income in the case of individuals the same definition of income applied in the case of corporations, and as the act had defined what income was in one case it was not necessary to define it in the other.

In other words, the court seems to hold that to include the proceeds of the policies as income would be to tax by "implication." We claim, however, that the

proceeds of the policies are included by direct language and that the court has been forced to resort to implication in order to exclude them. Everything not excluded is taxed. Everything not specifically excluded is income. This income is defined in the broadest conceivable language, and then the statute says that it—

> Does not include the following items, which shall be exempt from taxation under this title.

Everything is included that the statute does not exempt, and the first item exempted is the proceeds of life-insurance policies paid upon the death of the insured to *individual beneficiaries or their estates.* Then follows several other exemptions: The amount received by the insured as a return of premiums paid by him under life-insurance, endowment, or annuity contracts; the value of property acquired by gift, bequest, devise, or descent; interest upon the obligations of a State, Territory, or any political subdivision thereof, etc.; amounts received through accident or health insurance or under workmen's compensation acts, etc. It seems to us that the construction of the act by the Court of Claims fails wholly to give effect to the words "individual beneficiaries or to the estate of the insured." This language surely has a different meaning from the language employed in the acts of 1913, 1916, and 1917. According to the reasoning of the Court of Claims these words have no meaning, and the act of 1918 means the same as the acts of 1913 and 1921.

It needs no specific language in the act making the proceeds of insurance policies payable to a corporation to be included in gross income, in order that they shall be taxable as income. They are to be included unless they are exempted, and the language exempting them applies only to policies paid to individuals and to estates.

Where a taxpayer claims an exemption from the operation of the law, such law is to be construed most strongly against him.

The case of *Commercial Health and Accident Co.* v. *Pickering*, 281 Fed. 539, contains a résumé of the decisions laying down this rule. In that case the court said (p. 541):

> It is contended by the plaintiff that in interpreting revenue laws courts should consider them strictly in favor of the citizen. *Eidman* v. *Martinez*, *supra*. This is undoubtedly the general rule applicable to the enacting clause of a statute. However, here plaintiff seeks to bring itself within a proviso or a clause exempting certain classes of corporations, associations, and clubs which the act provides shall not be burdened with the tax. In construing such a provision we must be guided by the rule, which has long been adhered to, and which is announced in *United States* v. *Dickson*, 15 Pet. 141, where the court uses this language:
>
> "* * * We are led to the general rule of law, which has always prevailed, and become consecrated almost as a maxim in the interpretation of statutes, that where the enacting clause is general in its language and objects,

and a proviso is afterwards introduced, that proviso is construed strictly, and takes no case out of the enacting clause which does not fall fairly within its terms. In short, a proviso carves special exceptions only out of the enacting clause; and those who set up any such exception must establish it as being within the words as well as within the reason thereof."

A claim of exemption from taxation must be clearly made out. *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; *Perry Co.* v. *Norfolk*, 220 U. S. 472; *Vicksburg R. Co.* v. *Dennis*, 116 U. S. 665.

The Court of Claims reasons that the fact that the Act of 1921 exempts the proceeds of all life insurance policies leads to the conclusion that such was the congressional idea in the Act of 1918. This, however, loses sight entirely of the difference in the language, which has already been pointed out. It is respectfully submitted that the omission of the words "individual beneficiaries" in the Act of 1921 does not amount to a legislative construction of the Act of 1918 and to a declaration that it was never the intention of Congress to attempt to tax such proceeds of insurance as income. *United States* v. *Field*, 255 U. S. 257; *Shwab* v. *Doyle*, 258 U. S. 529; *Smietanka* v. *First Trust & Savings Bank*, 557 U. S. 602. In *Shwab* v. *Doyle*, 258 U. S. 529, this court, Mr. Justice McKenna writing, said (p. 536):

If Congress, however, had the purpose assigned by the commissioner, it should have declared it; when it had that purpose, it did declare it. In the Revenue Act of 1918, it

> reenacted section 202 of the Act of September 8, 1916, and provided that the transfer or trust should be taxed whether "made or created before or after the passage of" the act. *And we can not accept the explanation that this was an elucidation of the Act of 1916, and not an addition to it, as averred by defendant, but regard the Act of 1918 rather as a declaration of a new purpose;* not the explanation of an old one. [Italics ours.]

In the *Smietanka case* (257 U. S. 602, 606) this court said, Mr. Chief Justice Taft writing:

> This seems to us to graft something on the statute that is not there. It is an amendment and not a construction, and such an amendment was made in subsequent income-tax laws, as we shall see. * * *
>
> The Act of September 8, 1916, ch. 463, 39 Stat. 757, specifically declared that the income accumulated in trust for the benefit of unborn or unascertained persons should be taxed and assessed to the trustee. It is obvious that, in the acts subsequent to that of 1913, Congress sought to make specific provision for the *casus omissus* in the earlier act.
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> This case is not unlike that of *United States* v. *Field*, 255 U. S. 257.

In the case of *New York Trust Company* v. *Eisner*, 256 U. S. 345, it was argued that Congress did not intend that State inheritance taxes should be included in the estate taxable under the Act of 1916, because by the amendment in the Act of 1918 they were specifically stated not to be deductible, but this court refused to sustain the contention. It seems to us,

however, that a conclusive answer to the inference drawn by the Court of Claims is found in the successive amendments to this feature of the law which we have before pointed out in the various acts from 1913 to 1921. Under each one of these Acts prior to 1921 the Commissioner of Internal Revenue has made rulings (T. D. 2090, T. D. 2519, and Regulations 45, Art. 294) construing the application of the exemption to individuals only and excluding corporations. Congress never saw fit to enlarge these rulings until 1921, and under the rule often expressed by this Court these rulings of the Commissioner must be treated as read into the statute. (*New Haven R. R.* v. *Interstate Com. Comm.*, 200 U. S. 401.)

II.

Proceeds of life insurance policies on the lives of officers of a corporation taken out by it for its benefit constitute income within the meaning of the Sixteenth Amendment when received by the corporation.

The Court of Claims holds not merely that proceeds of these policies were not intended by the Act of Congress to be included as income, but also holds that they were not income within the legal definition of the word as given by this court in the case of *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 518. In that case the court said:

> Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.

This definition was somewhat elaborated in the case of *United States* v. *Phellis*, 257 U. S. 156, but these definitions must be construed with reference to the facts then under consideration. In the *Smietanka case* the question related to the gains or profits derived by the sale by a testamentary trustee of the personal property of the estate which had appreciated over its market value of March 1, 1913, and in the *Phellis case* the question related to securities received by the taxpayer upon a reorganization of a corporation in which he was a stockholder. There is nothing in these cases which holds that a gain received by a corporation in cash, as a result of a cash investment—an increase in the book value of its tangible assets by reason of the exercise of intelligence, foresight, and skill in the expenditure of money by its officers—is not income. When this court said that income was "gain derived from capital, from labor, or from both combined," it did not intend to exclude the effect of brains prudently and thoughtfully applied. If the sum of $97,000 obtained by a corporation as the result of an expenditure of $2,000 was not gain, what was it? Gain is income, unless it is an unrealized and unsevered increment of capital. When this money was received by the corporation from the insurance companies, it must have been entered upon the corporate books, and we know of no place to enter it except upon its capital account or upon its income account. It did not result from the sale of capital stock or of assets theretofore carried in its capital

account. It did not represent a mere marking up of book value of fixed assets, as in the case of real estate. When the premiums on these policies were paid the cash account must have been credited and some account debited, and when the proceeds of the policies were received by the company the cash account must have been debited and the other account credited, and the difference, we submit, should have been carried into the profit and loss account as a profit. But the Court of Claims reasons that the contract of insurance was a contract to indemnify the plaintiff for the loss which it would incur by reason of the death of its president and says:

> The plaintiff company did not invest money with any expectation that it would receive a return for it.

If this company did not invest the money with any expectation of receiving a return from it, for what purpose did it invest it and what right did it have to make the expenditure? It certainly was not a contribution to charity, and possibly it is too broad a statement to say that it did expect a return in money. It was a prudent, sagacious investment, and only the result could determine whether it would be profitable or not. In other words, it was like many other wise and prudent expenditures. It was a case of corporate bread upon the waters and the return came more quickly than was anticipated. If, as the Court of Claims says, it was a contract of indemnity, against what did the company seek to be indemnified?

Against the death of its president of course, but if the president had died without the contract of indemnity, could the corporation have charged off anything by way of depreciation, amortization, obsolescence, or depletion? It is to be noted that there is no finding to the effect that Mr. Biddle was under contract with the company to remain in its service. He could have left at any time. The directors could have displaced him at any time or he might have become incapacitated by illness. No stock had been issued against him as a capital asset. He was not carried on their books as an asset. His death made no change which the law could recognize in the assets, liabilities, or capitalization of the company. The only fact shown by the books of the corporation as the result of his death was an increase in its cash assets from the proceeds of these insurance policies. The question presented is quite different from that of insurance against fire or other casualty. When property is destroyed by fire, earthquake, flood, or tornado, a taxpayer is allowed to deduct as a loss the value of the property destroyed unless it is insured. Then he is entitled to deduct only such loss as is not covered by the indemnity. Cash received under such circumstances as indemnity for losses is not of course income. It merely prevents the writing off of a loss and makes good assets representing previous expenditures of capital. If the policies be regarded as indemnity for loss of profits which the company might expect to receive had he continued to live, this result would follow: Had he lived and

the company earned the profits, they would have been taxable and the Government would have received its tax thereon. When he died the company received the profits all at once and it was equally taxable. Why should the Government be deprived of the tax which it would have received upon these prospective profits when, by reason of the business prudence of the directors, the corporation received the profits as a result of his death?

Life insurance, ordinarily speaking, is not a contract of indemnity. To be sure, the element known as an insurable interest has been long regarded as necessary to the validity of an insurance contract. The principle was formulated in the English courts soon after the idea of life insurance became a general feature of modern life, and was regarded as essential in order to take the contract out of that class known as wagering contracts and in order that public policy might be satisfied. The insurable interest, however, although essential in the inception of the contract, need not continue throughout its life. This court in the case of *Connecticut Mutual Life Insurance Co.* v. *Schaefer*, 94 U. S. 457, 461–462, speaking by Mr. Justice Bradley, said:

> We do not hesitate to say, however, that a policy taken out in good faith, and valid at its inception, is not avoided by the cessation of the insurable interest, unless such be the necessary effect of the provisions of the policy itself. Of course, a colorable or merely temporary interest would present circumstances

from which want of good faith and an intent to evade the rule might be inferred. And in cases where the insurance is effected merely by way of indemnity, as where a creditor insures the life of his debtor, for the purpose of securing his debt, the amount of insurable interest is the amount of the debt.

But supposing a fair and proper insurable interest, of whatever kind, to exist at the time of taking out the policy, and that it be taken out in good faith, the object and purpose of the rule which condemns wager policies is sufficiently attained; and there is then no good reason why the contract should not be carried out according to its terms. This is more manifest where the consideration is liquidated by a single premium paid in advance than where it is distributed in annual payments during the insured life. But, in any case, it would be very difficult, after the policy had continued for any considerable time, for the courts, without the aid of legislation, to attempt an adjustment of equities arising from a cessation of interest in the insured life. A right to receive the equitable value of the policy would probably come as near to a proper adjustment as any that could be devised. But if the parties themselves do not provide for the contingency the courts can not do it for them.

The logical answer to the argument that these insurance proceeds are not taxable because they are indemnity is that they are indemnity against a loss that would not be deductible. They are therefore

gain. If the taxpayer receives insurance to compensate him for a loss that is not recognized by the statute, he must account for a gain, because his capital remains intact and he has acquired something of a money value in addition. Of course, speaking colloquially, it is frequently said, and is undoubtedly true, that the services of a given individual are an asset to the firm or corporation with which he is connected, but no such colloquial conception of the relation between the individual and the corporation can be accepted here in order that the respondent may recover on the theory that what it receives was a reimbursement for the loss of a capital asset. We are not concerned with the colloquial use of the term. We are concerned merely with the question of corporate accounting with reference to a taxing statute. Looking at the service of respondent's president in this light, stripped of all elements of sentiment, it is clear that they do not stand the tests to be applied in ascertaining whether or not his services were a capital asset. If the corporation had bound Mr. Biddle by contract to serve with them for a definite number of years, and if the laws of the State under which the corporation was organized permitted it, it might be that that contract could have been carried upon the corporate books as an asset and possibly as a consideration for the issuing of stock. Under such circumstances, had the corporation taken out a policy of insurance upon his life it would seem to be reasonable to hold that upon his death the proceeds of the policy might have been used to

make good the loss represented by the stock issued or the capitalized value of the contract. But that is not the present case, and under no principle of law or of accounting with which we are familiar could the mere fact that he was an able, skillful, and successful man be treated as a corporate asset having a cash value. The ordinary idea of an asset excludes everything that may not be used in some form or another by a corporation to liquidate its liabilities. In *Marvin* v. *Mayesville Street R. R. & Transfer Co.*, 49 Fed. 436, 437, the court discussing what were assets of a decedent, referred to the definition of Mr. Justice Story, in the following language:

> In an accurate and legal sense, all the personal property of the deceased, which is of a salable nature, and may be converted into ready money, is deemed "assets." But the word is not confined to such property; for all other property of the deceased which is chargeable with his debts or legacies, and is applicable to the purpose, is, in a large sense, assets.

Of course, the proportion between the tax which the respondent was required to pay and the amount of the proceeds of the policies seems to be so disproportionate as to make one reluctant to sustain the tax. That, however, is not a consideration for the court. The taxes imposed during the war were the most drastic ever heard of in this country, and in many cases they resulted in real hardship and seeming injustice. The respondent, subject to both the income and the excess profits tax, was, by reason

of the relation between its capital and its income, subject to taxation in the higher brackets. Nevertheless, taxation at these rates was fixed by the act, and this company was in no different position from thousands of other companies. Any argument based upon the size of the tax is an appeal to sympathy, not to law.

CONCLUSION.

Congress had the power to levy a tax upon incomes from whatever source derived.

The Revenue Act of 1918 included in gross income the proceeds of life insurance policies except those specifically exempted—that is, those payable to an individual or to his estate. The policies in question were not so payable, but were payable to a corporation and became part of its income for the taxable year. Had Mr. Biddle lived, the income resulting from his management would have been taxable under the Sixteenth Amendment, which provides for taxes on incomes from whatever source derived, and the proceeds of the policies took the place of that income.

The judgment of the Court of Claims should be reversed.

Respectfully submitted.

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